No. 15156

In the United States Court of Appeals for the Ninth Circuit

R. H. PHILLIPS AND JESSIE E. PHILLIPS, HIS WIFE, R. R. HAGGERTY AND WINNIE HAGGERTY, HIS WIFE, AND D. EVERETT PHILLIPS AND EVELYN PHILLIPS, HIS WIFE, INDIVIDUALLY AND IN BEHALF OF THE COLD CREEK COMPANY, A PARTNERSHIP, APPELLANTS

v.

UNITED STATES OF AMERICA, APPELLEE

UPON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION

BRIEF FOR THE UNITED STATES, APPELLEE

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INDEX

CITATIONS

409778—56——1

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No. 15156

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v.

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UPON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION

BRIEF FOR THE UNITED STATES, APPELLEE

OPINION BELOW

The district court did not write an opinion.

JURISDICTION

The jurisdiction of the district court over these four condemnation proceedings was invoked under the Acts of August 1, 1888, 26 Stat. 357, 40 U. S. C. sec. 257; August 18, 1890, as amended, 50 U. S. C. sec. 171 and under acts authorizing the takings and appropriating funds therefor (R. 23–24, 28). Judgments determining compensation were entered No-

vember 30, 1955 (R. 50–74). A timely consolidated motion for a new trial (R. 74–78) was denied on January 6, 1956 (R. 78–79), and notices of appeal were filed March 2, 1956 (R. 79–81). The jurisdiction of this Court rests upon 28 U. S. C. sec. 1291.

QUESTIONS PRESENTED

1. Whether the trial court erred in denying admission of the proof offered by appellants in support of their claim to separate mineral values of the 33,000-acre ranch condemned.

2. Whether, if there was error in such denial, it vitiated the entire trial determining market value and market rental value of the ranch.

STATEMENT

R. H. Phillips, D. Everett Phillips and R. R. Haggerty, with their wives, were the owners of a ranch in eastern Washington, of some 33,200 acres. Civil No. 892 is a proceeding commenced by the United States in February 1954, to condemn the ranch for use in connection with the Yakima Artillery and Anti-Aircraft Firing Range. Trial was consolidated with three other cases, Civil Nos. 452, 488, and 762, which were the taking of temporary use of portions of the ranch commencing February 1950, July 1950, and October 1952 (R. 257).

Extensive evidence was presented at the trial which commenced on October 24, 1955, and concluded with return of the jury's verdicts on November 4, 1955. Witnesses for both parties generally agreed that the best use of the property was for a cattle and sheep

range. As illustrated by testimony of the Government's expert C. Marc Miller in the printed record, considerable emphasis was given to sales of comparable properties (R. 106–121). Thus the instructions to the jury included consideration of sales of comparable properties and of properties condemned, the first of the ranches which had been consolidated into the property taken having been bought in June of 1948 (R. 146, 260–261). The court, in briefly commenting on the evidence, drew attention to the divergence of the experts as to which sales were of property comparable to that taken as explaining the wide spread between the parties' valuations (R. 268). In the fee-taking case the government witnesses had estimated value at $335,000 and $425,000, while three experts for the owners gave figures of $1,461,340, $1,450,154, and $1,410,477 (R. 49). The jury's verdict for the fee taking was $514,801.56 (R. 49).

The proceedings at the trial with regard to the claim of mineral values may be summarized as follows:

Prior to trial appellants had petitioned for a dismissal from the case of mineral rights but this petition was denied (R. 40–42). When the trial commenced on October 24, the court expressed its concern over the mineral rights question and referred to an earlier case where it had submitted to the jury the question of enhancement because of the possibility of leasing for exploration purposes. The court expressed doubt as to how, as a practical matter, proof could be given as to how much the possibility of leasing for exploration purposes would enhance the market value

of the land (R. 89–90). The subject was again briefly mentioned on October 31 with regard to exclusion of mineral rights reserved by the Northern Pacific Railway, which presented different questions arising out of the land grant to the railroad from the United States (R. 128–130). The following day, the mineral value question was adverted to briefly. Appellants' counsel stated that there was commercial production of gas within seven miles of this ranch for eleven years but which, as the court brought out, stopped in 1929 or 1931 (R. 134–136). At the end of that day's trial there was another colloquy which concluded with the court's suggestion that an offer of proof might avoid the need of calling witnesses (R. 172–175).

During the examination of one of the owners, Exhibit 96, an option for a mineral rights lease, and Exhibit 97, a lease to Shell Oil Company, were offered, not as to mineral values, but to show the state of the title (R. 206–209). After discussion, the court reserved a ruling until offer of proof should be made as to mineral values (R. 209–213). A similar ruling was made as to Exhibit 120, a mineral rights deed to the Cold Creek Company which is a partnership composed of the owners Phillips and Haggerty, plus Walter Swanson, who has a ten percent interest (R. 233–234).

At the end of the landowners' case the offer of proof was made, the matter was argued and the offer was denied (R. 236–254). In the subsequent instructions the jury was told that the court had concluded

that there had been shown no substantial value for mineral rights and the jury was not to award any value for mineral rights (R. 259–260). Appellants excepted to this instruction (R. 275).

ARGUMENT

I

The Court properly rejected the offer of proof of evidence seeking to establish alleged mineral values

We will discuss in detail the deficiencies of appellants' offer of proof later. However, we believe that its inadequacy is apparent when the question is asked, "How could the jury arrive at a dollars or cents figure for a mineral interest except by pure guess? The answer is, they couldn't. As the court said: "If they [the jury] returned a verdict, as the owners hope they will, of upward of a million dollars, no one could ever tell whether $10 or $500,000 of that was based upon their idea of what these minerals might be worth * * *" (R. 254).

A. A condemnation award may not be based on pure guesswork

Constantly reiterated is the thought that the award in a condemnation case must be fair both to the landowner and to the public. *United States* v. *Miller,* 317 U. S. 369 (1943). While just compensation includes all elements of value that inhere in the property, it does not exceed market value fairly determined. "Considerations that may not reasonably be held to affect market value are excluded. * * * Elements affecting value that depend upon events or combinations of occurrences which, while within the realm of possibility, are not fairly shown to be reasonably

probable, should be excluded from consideration, for that would be to allow mere speculation and conjecture to become a guide for the ascertainment of value—a thing to be condemned in business transactions as well as in judicial ascertainment of truth." *Olson* v. *United States,* 292 U. S. 246, 256, 257 (1934). "Value cannot be placed upon a remote possibility." *Mayor and City Council of Baltimore* v. *United States,* 147 F. 2d 786, 791 (C. A. 4, 1945); *People of Puerto Rico* v. *United States,* 132 F. 2d 220 (C. A. 1, 1942), certiorari denied, 319 U. S. 752; *Borough of Munhall* v. *United States,* 159 F. 2d 603 (C. A. 3, 1947); *Cameron Development Company* v. *United States,* 145 F. 2d 209 (C. A. 5, 1944). In *Sharp* v. *United States,* 191 U. S. 341 (1903), one of the reasons given for excluding evidence of an offer is that (p. 348): "Pure speculation may have induced it, a willingness to take chances that some new use of the land might in the end prove profitable." While, as we discuss later, the nature of mineral operation, especially oil and gas, may require some modification of the "reasonably probable" language in application it does not justify departure from the rule excluding alleged values founded purely on conjecture. Cf. *United States* v. *Harrell,* 133 F. 2d 504 (C. A. 8, 1943).

B. Appellants made no offer to prove that the market value of the land was enhanced to any extent by the possibility, however remote, of the existence of minerals

Generally, property condemned by the United States is valued as an entity. The various components, such as timber, minerals, etc., are not separately valued

but are considered only to the extent that they enhance the value of the land as a unit. Thus, when value is founded, as it should be, on sales of comparable properties, the enhancement represented by those components is automatically reflected in the sales. Here, there was a great deal of evidence relating to the sales of the property condemned to appellants in 1948 and the following years and of sales of ranches in the neighborhood (see Statement, *supra,* p. 3). And existing mineral possibilities would be reflected in those prices. It should be noted that appellant D. Everett Phillips testified (R. 144):

> Q. Is it true, as counsel brought out, that you bought it at range land prices?
>
> A. Yes, that is one reason why the sales here are quite close together. We realized it as potential farm ground and naturally we made the deals as soon as we could.

The only mention of this subject in the offer of proof as to mineral values is that "the recent sales of lands that we have mentioned south of this and adjoining this property have all had a reservation of mineral rights in each case" (R. 240). Appellants did not offer to show that the sales the Government relied upon as comparable also included reservations of minerals by the vendor nor did they offer to show that the price obtained either in the Government's comparable sales or even in their own was any less because of the mineral reservation. There was, thus, a complete absence of evidence to show that the fee value was enhanced by the possibility of mineral ex-

409778—56——2

traction or, put conversely, that the comparable sales, at least those relied upon by government witnesses, did not include every element of value present in the land.

The court suggested (R. 92) that oil production would not be inconsistent with agricultural value. We are not concerned here with minerals under production, but the effect, if any, upon market value of the possibility of existence of minerals. Thus, in affirming the ultimate award in *Eagle Lake Improvement Co.* v. *United States,* 160 F. 2d 182 (C. A. 5, 1947), appellants' prime authority (Br. 18–19, 21, 24–25), the Court of Appeals for the Fifth Circuit held that even when there were outstanding mineral leases that the owners of mineral interests were not entitled to a separate trial and that evidence of market value of the whole property was admissible. Appellants are in the contradictory position of asking for a reversal of the judgments in their entirety (see *infra,* p. 14) without offering any evidence indicating that market value of the property as a whole was enhanced because of the possibility of mineral development.

C. Appellants made no offer to show facts which would reasonably establish the existence of a market in mineral leases or mineral rights

In the trial court appellants' counsel frequently used the term "active leasing area." In the brief on appeal the claim is made that testimony of Mr. Beam was offered "as to dealings in mineral leases and rights in the area" (Br. 5), and, it is said that appellants "could have shown many sales of lessor and lessee rights in lands with speculative values" (Br.

21). But the basic defect in the offer of proof was the lack of showing of an active market. Contrary to the brief's statement, Mr. Swanson, in response to the court's question, said: "I'm not sure whether any of them have been sold in this area or bought excepting as part of the purchase and sale of all these ranches that are being purchased and sold in this area" (R. 171). And the offer of Mr. Beam, a so-called "lease man" was to show, not that trading in leases existed in the area, but only "that there is dealings in areas similar to this where there has not been a strike of oil" (R. 241).[1] This is a far cry from the situation to which appellants seek to equate this case (Br. 20), where "the uncertainties are such that the mineral interests in the condemned lands are bought and sold at arms-length transactions for valuable considerations, they have a market price translated into a fair market value for condemnation purposes * * *." Appellant offered no evidence of such transactions for the obvious reason that they did not exist, as Mr. Swanson admitted. This was, we submit, fatal to the application of such cases as *Cal-Bay Corporation* v. *United States,* 169 F. 2d 15 (C. A. 9, 1948), certiorari denied, 335 U. S. 859, and *Eagle Lake Improvement Co.* v. *United States,* 141 F. 2d 562 (C. A. 5, 1944), and 160 F. 2d 182 (C. A. 5, 1947).

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[1] Appellants' evidence did not even go so far as the testimony found insufficient in *United States* v. *Harrell*, 133 F. 2d 504, 508 (C. A. 8, 1943), where it was stated that oil and gas leases in general in unproven territory of the character there involved, *in view of the evidence of possible future commercial production* were reasonably worth from $5 to $50 per acre.

There is a great difference between an "active leasing area," so frequently referred to by appellants and an active market of mineral interests. The leases referred to are simply for exploratory purposes like that of the Shell Oil Company to the lands here condemned, Exhibit 97. This provided for a delay rental of 25 cents per acre per year and could be canceled by the company at the end of any year. The offer of proof went no further than to say that other major companies were securing similar leases in the area. There was no offer to show the existence of any competition between the companies or other persons creating a market. Certainly the fact without more that such exploratory leases have been taken by major companies does not show a market. As Mr. Swanson admitted, in every such lease the company has the right to cancel (R. 240). We are not here concerned with possible rights of Shell Oil Company, which has made no claim, but only with those of appellants. There is absolutely nothing to show possible salable value of the lessor's rights except for the 25 cents per acre per year rental. But the continuance in the future of that rental rests simply on the guess as to what the managers of the appropriate divisions of the Shell Oil Company might decide to do. The fact is well known that the major companies all have millions of acres under exploratory leases which are periodically reviewed for exploration, continued retention or discontinuance. Certainly just compensation should not rest on nor should

a jury be called upon to investigate the intentions of such managers as to this particular area.[2]

Exhibit 96, an option from appellants to Laurent Regimbal, has, if possible, even less bearing upon an alleged market value. It was simply an option to take an exploratory lease expiring December 31, 1955. To the other imponderables above mentioned is added the question as to how much land, if any (in quarter sections), the option might be exercised. The deed upon which appellants rely as having constituted a severance of the minerals from the land (R. 233) likewise has no tendency to establish any ascertainable market value. The deed, Exhibit 120, conveyed the minerals to a partnership in which the only outstanding interest was the 10% of Mr. Swanson. There is no indication of substantial consideration having been paid therefor. Certainly such a bootstraps arrangement cannot be used to establish rights to substantial compensation for such alleged mineral values. And it should further be noted that while Mr. Swanson appeared as a claimant in the court below and joined in the motion for a new trial (R. 74–76), he did not join as a party in the notices of appeal (R. 79–81) and hence does not appear in the caption of the case as a party. At best, the deed would be comparable to the transactions between the claimants in *United States* v. *Harrell,* 133 F. 2d 504, 508 (C. A. 8, 1943),

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[2] Appellants are not entitled to recover the royalties or rentals they might possibly have secured. And "Probable future profits based upon conjecture are too remote to aid in the determination of market value." *Murdock* v. *United States*, 160 F. 2d 358, 360–361 (C. A. 8, 1947), and cases there cited.

which the court held "afford no substantial evidence of the real value of the leases."

Finally as to geological probabilities of oil or gas deposits the proffer simply is that there are several factors which govern the decision of a major oil company to explore for oil and "There are more than one of the factors present in the area here" (R. 239). Thus, no attempt was made even to show a chance geologically of commercial oil discovery but only the possibility that a major oil company might take some exploratory action. The one physical fact—that for eleven years ending in 1929 or 1931, there had been gas production some seven miles from the Phillips-Haggerty ranch—tends to discredit rather than support the hope of existence of commercially profitable deposits just as a dry hole does. The failure to reactivate that production for more than 25 years is like the iron mine which had not been worked for 30 years where the court said: "If there was present all of the value testified to, it seems inconceivable to me that it would not long ago have been retrieved." *United States* v. *Certain Lands, Etc.,* 51 F. Supp. 66 (S. D. N. Y., 1943). Clearly there was no substantial evidence of even a remote possibility of valuable mineral deposits.

D. The decided cases do not support appellants' claims

We have pointed out that here there was no market, active or otherwise, in mineral interests nor was there any fact tending to indicate the presence of minerals such as would create traffic among persons hoping to profit from exploitation of oil and gas. Facts justify-

ing such a belief were however present in every case sought to be invoked by appellants (Br. 17–19). Thus *Montana Railway Company* v. *Warren,* 137 U. S. 348 (1890), involved a mining claim adjoining the Anaconda claim, which had already been developed "with indications that the vein within such mine extends into this claim" (137 U. S. at p. 353). *Eagle Lake Improvement Co.* v. *United States,* 141 F. 2d 562 (C. A. 5, 1944), concerned, as stated by the second opinion in that case, 160 F. 2d 182 (C. A. 5, 1947), lands which lay "north and northwest of a number of oil producing wells in the Flour Bluff Oil Field." And in *Cal-Bay Corporation* v. *United States,* 169 F. 2d 15 (C. A. 9, 1948), certiorari denied, 335 U. S. 859, there was, in the words of this Court, "evidence that a well drilled upon it disclosed gas in commercial quantities," the well having cost over $250,000.

The present case bears not the slightest resemblance to those cited. Unless the fact alone that the Shell Oil Company had an exploratory lease, cancellable in any year on 1685.60 acres out of the 33,000 acres taken is substantial evidence of a market and can constitute the sole basis for establishing a market value for those mineral rights, appellants' claim must fail. Our discussion, we believe, has made it clear that the answer to the question posed at the commencement of our argument is that no possible ground is given from which the jury could logically determine a verdict of $10 rather than $100,000 or $1,000,000. The court was, therefore, entirely justified in refusing to permit confusion of the record by evidence which could not possibly be the basis for a legal verdict.

II

Any error in exclusion of evidence as to mineral values does not justify a new trial as to matters submitted to the jury

Appellants argue that all of the cases and issues should be retried, asserting that "their entire presentation as to all four consolidated cases was prejudiced" (Br. 26). The record is devoid of a single fact lending support to this notion and appellants suggest none, aside from characterizing the court's well-considered ruling as "arbitrary" (Br. 26), and charging it with having "a partisan attitude" (Br. 10). The mere fact of consolidation does not require reversal as to issues unrelated to the error. *Phillips* v. *United States,* 206 F. 2d 867 (C. A. 9, 1953). The mineral claim has no connection with the three leasehold cases. And the verdict as to market value of the fee title should not be disturbed since appellants' claim is not to enhancement of market value of the fee as shown by comparable sales but is for a separate mineral value in addition to the ranch value award (see *supra,* p. 68). No justification exists for imposing upon the court and the parties a lengthy retrial upon that matter. We submit that even should this Court find that error was committed in the exclusion of the offered evidence, the retrial should be limited to mineral values.

CONCLUSION

For the foregoing reasons it is submitted that the judgments of the district court should be, in all respects, affirmed.

Respectfully,

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DECEMBER 1956.

U. S. GOVERNMENT PRINTING OFFICE: 1956